

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
STANLEY AND JEAN COHEN	:	DETERMINATION
	:	DTA NO. 818415
for Redetermination of a Deficiency or for Refund of	:	
New York State Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1987 and 1988.	:	

Petitioners, Stanley and Jean Cohen, 12 Pond View Court, Jericho, New York 11753, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1987 and 1988.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 20, 2002 at 10:00 A.M., with all briefs to be submitted by September 6, 2002, which date began the six-month period for the issuance of this determination. Petitioners appeared by Kestenbaum & Mark, Esqs. (Bernard S. Mark, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Kevin R. Law, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly disallowed petitioners' refund claims based upon claimed net operating losses from the years 1990, 1991 and 1992 which petitioners carried back to eliminate income tax deficiencies for the years at issue.

II. Whether penalties and interest imposed upon such deficiencies were properly imposed.

FINDINGS OF FACT

1. On October 29, 1998, the Division of Taxation (“Division”) issued to Stanley and Jean Cohen (“petitioners”) a Notice of Additional Tax Due for each of the years 1987 and 1988 which asserted the following deficiencies:

Period Ended	Tax	Interest	Penalty	Total Due
12-31-87	22,870.55	29,029.35	22,444.54	74,344.44
12-31-88	4,523.09	5,012.50	2,869.01	12,404.60

Each Notice of Additional Tax Due contained an explanation which stated, in part, as follows:

Our records indicate that the Internal Revenue Service has made changes to your federal return. Section 659 of the New York State Law [sic] requires that federal audit changes be reported to the New York State Tax Department within 90 days of the final federal determination.

* * *

When you do not report federal audit changes as required, the New York Tax Law provides for assessment of the tax due at any time. There is no time limit provided by section 683(c) of the New York Tax Law.

Total New York income/New York adjusted gross income has been corrected to include the federal adjustment.

For both of the years at issue, a negligence penalty of 5% was imposed pursuant to Tax Law § 685(b)(1) and a penalty pursuant to Tax Law § 685(b)(2), equal to 50% of any interest due attributable to negligence or intentional disregard of the Tax Law, was also imposed. For the year 1987, a penalty for late filing (5% per month up to a maximum of 25%) was also imposed pursuant to Tax Law § 685(a)(1).

2. During the years at issue, petitioner Stanley Cohen was an executive in a firm and was also trading, as a day trader, in securities on his own account. He was a partner and stockholder in several real estate companies.

3. On November 23, 1992, the Internal Revenue Service (“IRS”) issued a Notice of Deficiency with Income Tax Examination Changes to petitioners¹ for each of the years 1985 through 1988.² Petitioners challenged the deficiencies in the United States Tax Court. Subsequently, petitioners and the IRS entered into stipulations of settled issues thereby settling all of the issues relating to the tax deficiencies and left, for decision by the court, all issues relating to additions to tax which had been imposed pursuant to IRC §§ 6651, 6653 and 6661.³

Pursuant to the settlement between petitioners and the IRS, it was agreed that petitioners’ 1987 Federal taxable income would be adjusted as follows:

- a. Schedule C (Profit or [Loss] from Business or Profession) losses of \$80,579.00 were disallowed;
- b. Net operating loss from 1986 of \$84,245.00 was disallowed;
- c. Schedule E (Supplemental Income & Loss) losses of \$144,468.00 were disallowed;
- d. Capital losses of \$3,000.00 were allowed.

For 1988, petitioners’ Federal taxable income was adjusted as follows:

- a. Schedule C losses of \$95,123.00 were disallowed;

¹ All references to “petitioner” are to petitioner Stanley Cohen since all of the income at issue was earned by Stanley Cohen. Jean Cohen is a party by virtue of the fact that petitioners filed joint returns for all of the years at issue.

² Since, for purposes of the present matter, only the years 1987 and 1988 are at issue, only Federal changes pertaining to those years are set forth herein.

³ Pursuant to *Cohen v. Commissioner* (72 TCM 1503), deficiencies in income tax were determined to be due from petitioners in the amounts of \$92,439.00 for 1987 and \$12,544.00 for 1988. Petitioners were also held liable for each of the additions to tax for the years 1987 and 1988. The decision of the Tax Court was entered on February 14, 1997.

- b. Schedule E losses of \$379,613.00 were disallowed;
- c. Capital losses of \$3,000.00 were allowed;
- d. \$717.00 of itemized deductions were disallowed.

4. For 1987, petitioner claimed Schedule E losses from his involvement in the following partnerships and Subchapter S corporations: KRS Associates, KBS Motel, KRS Restaurant and A. King #1. As noted by the IRS on its Explanation of Adjustments: “Your distributive share of the Partnership or S Corporation loss is limited to the extent of your adjusted basis and amount at risk.” Losses from KBS Motel, KRS Restaurant and A. King #1 were disallowed because petitioner had no basis or amount at risk available to absorb any losses.

In 1988, petitioner claimed Schedule E losses from KRS Associates, KBS Motel and KRS Restaurant. Losses from KBS Motel and KRS Restaurant were disallowed because petitioner had no basis or amount at risk available to absorb any losses.

5. Petitioners did not timely file their Federal returns for the years 1990, 1991 and 1992. Pursuant to a letter from the IRS dated November 10, 1999, it was determined that these returns were filed as follows:

1990 Form 1040 - Return due 04/15/91
Extension filed to 10/15/91
Delinquent Return received 10/24/94

1991 Form 1040 - Return due 04/15/92
Extension filed to 10/15/92
Delinquent Return received 10/28/94

1992 Form 1040 - Return due 04/15/93
Extension filed to 10/15/93
Delinquent Return received 06/21/95

The November 10, 1999 letter also stated that “[t]he Delinquent Returns were accepted as filed.”

6. On their 1990 Federal income tax return, petitioners claimed a net operating loss of \$97,422.00. On their 1991 Federal return, they claimed a net operating loss of \$158,221.00 and on their 1992 Federal return, petitioners claimed a net operating loss in the amount of \$143,186.00.

7. At the hearing, petitioners requested time to submit additional documentation to support their position. On April 29, 2002, petitioners submitted:

a. A letter dated March 8, 1994, from petitioners' representatives to the accountant who filed the tax returns for the Harrisburg Inn Joint Venture and the Carlisle Inn Joint Venture which advised that the joint ventures had not properly reported losses for the years 1986 through 1992. Specifically, the letter indicated that one of the partners of the joint venture was KBS Motel Associates, L.P. and not KBS Motel Corp. It stated that as a result of the filing of KBS Motel Corp. as a joint venture partner instead of KBS Motel Associates, L.P., petitioner might be denied losses otherwise allowable because of the basis rules of the Internal Revenue Code. Petitioners' representative further advised the accountant that in order to ensure proper treatment of the joint venture losses for the years 1990 through 1992, form 8082 (Notice of Inconsistent Treatment or Amended Return) must be filed with amended returns. The letter stated that protective forms 8082 had been filed by petitioners' representatives "as required by the United States Tax Court." On these forms 8082 for each of the years 1990 through 1992, petitioners indicated that the pass through entity was KBS Motel Associates, L.P. and, as an explanation, stated: "The Partnership return has not been filed. If filed, the taxpayers would report a loss which can be claimed for their taxable year and unused losses can be carried back to prior years."

b. Letters dated September 29, 1997 from IRS Agent Victor M. Szczepanski to petitioners and petitioners' representative which indicated that in order to process the forms 8082 and to allow petitioners to claim the flow through losses from the KBS Motel Associates Limited Partnership, he would need additional information to verify petitioner's adjusted basis in the limited partnership including: his share of the liabilities, copies of canceled checks, partnership agreement and documentation verifying the net operating loss claimed on the 1992 return.

c. A letter from petitioners' representative to the IRS agent, dated October 28, 1997, and attachments including the agreement of limited partnership for KBS Motel Associates Limited Partnership and copies of certain loan notes and guarantees in favor of Manufacturer's Hanover Trust Company. The letter also stated that petitioners' representative was attempting to secure documentation verifying the net operating loss carryover of \$255,643.00 on the 1992 return.

d. A letter from petitioners' representative to the IRS agent, dated November 3, 1997, and attachments which were being provided to verify the net operating loss carryover of \$255,643.00 on the 1992 return.⁴

e. A letter to petitioners from IRS Agent Szczepanski, dated March 24, 1998, relative to petitioners' 1990, 1991 and 1992 returns which stated that no changes had been made to the tax reported. The letter indicated, however, that a change could later be made if petitioners were shareholders in a subchapter S corporation, a beneficiary of a trust or a partner in a partnership. If the IRS examined the returns of the S corporation, trust or

⁴ The documentation submitted by petitioners indicates that the \$255,643.00 net operating loss figure was derived from 1991 net operating loss of \$158,221.00 plus the 1990 net operating loss of \$97,422.00 which had been carried forward to 1992.

partnership and changes resulted from that examination, such changes could affect petitioners' returns.

8. On September 29, 1998, the IRS received from petitioners a form 1040X, Amended U.S. Individual Income Tax Return for each of the years 1987 and 1988. The amended return for 1987 indicated that it had been "amended to reflect carry back of partnership losses allowed by the Internal Revenue Service." The losses were: 1990 - \$97,422.00; 1991 - \$158,221.00; and 1992 - \$60,649.00. The amended return for 1988 contained the same explanation and indicated that the loss was \$82,537.00 from 1992. Pursuant to a request for additional information from the IRS on October 14, 1998, petitioners, on November 5, 1998 submitted copies of the first two pages of their 1990, 1991 and 1992 returns along with a form 1045, Application for Tentative Refund with "diagnostics" (computations) from the 1990, 1991 and 1992 returns showing the computations of net operating losses for each of these years. The 1990 diagnostic indicates that the 1990 net operating loss, as well as certain other losses, were being carried over to 1991. The 1991 diagnostic states that the 1991 net operating loss was being carried over to 1992 and the 1992 diagnostic states that the 1992 net operating loss was being carried over to 1993. However, upon review of these returns, it is clear that the net operating losses were not carried over to subsequent years.⁵

9. On the same date on which petitioners submitted the aforesaid additional information to the IRS, i.e., November 5, 1998, petitioners' representative also responded to the Notices of Additional Tax Due which had been issued by the Division on October 29, 1998 (*see*, Finding of Fact "1") by a letter which stated, in relevant part, as follows:

⁵ It must be noted that since petitioners' 1993 Federal return is not part of the record, it cannot be determined, with certainty, that the 1992 NOL was not carried over to 1993.

My clients have filed amended Income Tax Returns for years 1987 and 1988 reflecting Carry Back losses to eliminate the tax liability for those years. As soon as we receive acknowledgement [sic] from the Internal Revenue Service that they [sic] have approved these Amended Returns, we will transmit this information to you.

On form DTF-968.1, petitioners also indicated that they disagreed with the amounts asserted to be due by the Division and stated thereon that amended tax returns had been filed on November 5, 1998.

10. Petitioners filed a form IT-201-X, Amended Resident Income Tax Return for each of the years 1987 and 1988 (the returns were dated May 12, 1999). On the 1987 amended return, the explanation set forth thereon was that the return had been amended to reflect carry back of partnership losses allowed by the IRS (1990 - \$97,422.00, 1991 - \$158,221.00, 1992 - \$60,649.00). The 1988 amended return contained the same explanation, but the loss carried back was from 1992 in the amount of \$82,537.00.

11. On October 28, 1999, petitioners' representative sent a letter to the IRS which stated, in pertinent part, as follows:

I am enclosing herewith for your consideration, copies of your previously provided reports indicating that the taxpayers' amended returns for the 1990-1992 years were accepted as filed. At this time, we need to determine the status of the net operating [sic] carry backs from these returns to the 1987 and 1988 years. It would be most helpful if you could write us a letter indicating that the NOL's have been accepted, and in any event, transcripts for all years would probably show the same information. I respectfully request your immediate attention to this matter, as New York State is waiting to approve State filed amended returns and net operating loss carry backs based on the acceptance of the Service's returns for the years in issue.

The IRS responded to this letter on November 10, 1999, stating that the Cohen account had been researched and that the 1990, 1991 and 1992 returns were not amended but rather were delinquent returns. The IRS letter set forth the due dates, extension dates and dates of actual

filing of the 1990, 1991 and 1992 returns and indicated that the delinquent returns were accepted as filed (*see*, Finding of Fact “4”). No specific mention was made of net operating loss carry backs.

12. On December 20, 1999, the Division issued a Response to Taxpayer Inquiry (form DTF-972.5) relating to the tax deficiencies for 1987 and 1988 which stated, in part, as follows:

The above assessment(s) has been sustained.

For NYS resident taxpayers the starting point for computing the New York adjusted gross income is federal adjusted gross income. Accordingly, a resident taxpayer is allowed the same amount of net operating loss deduction included in the computation of federal adjusted gross income.

Since your net operating loss was not allowed with the IRS due to an Offer in Compromise no net operating loss may be allowed by NYS.

The letter dated 11/30/99 from your representative, Bernard Mark, along with the Power of Attorney, requesting a similar Offer in Compromise with New York State has been forwarded to the appropriate office.

13. At the hearing, petitioners’ attorney, Bernard S. Mark, indicated that the IRS had accepted petitioners’ offer in compromise but that the State of New York had not accepted petitioners’ offer in compromise due to petitioner Stanley Cohen’s pending criminal matters.⁶ Petitioners offered no evidence to indicate that the IRS had accepted an offer in compromise.

SUMMARY OF THE PARTIES’ POSITIONS

14. Petitioners contend that Federal returns were filed for the years 1990 through 1992 in which losses were claimed from petitioner’s investment in KBS Motel Associates, L.P. Upon examination of these returns by the IRS, the returns reflecting these losses were accepted by the

⁶ Petitioner Stanley Cohen was convicted of perjury and related crimes; the appeal of the conviction is presently pending. He was advised by counsel (Attorney Paul Schechtman) to invoke his Fifth Amendment right against self-incrimination if questioned about any matter that could affect his criminal matter. However, Stanley Cohen did not appear and offer testimony at this hearing.

IRS. Thereafter, petitioners' accountant filed amended Federal returns for 1987 and 1988 which claimed net operating loss carry backs from the years 1990 through 1992 to 1987 and 1988.

Petitioners assert that these carrybacks were accepted by the IRS. Petitioners' accountant then filed amended New York State returns for 1987 and 1988 which similarly claimed these net operating loss carrybacks. Therefore, petitioners maintain that the net operating loss carry backs must also be allowed by the Division.

In their reply brief, petitioners state that the Division's statute of limitations argument is misplaced since the opportunity to carry back the losses did not arise until the time of the decision of the Tax Court and until the adjusted basis was established by the submission of the returns filed for 1990, 1991 and 1992.

15. The Division, in response, asserts:

- a. Petitioners did not prove that they actually incurred net operating losses during 1990, 1991 and 1992 which could be carried back to offset income tax deficiencies for 1987 and 1988;
- b. There is no evidence that the IRS utilized net operating losses from 1990, 1991 and 1992 in arriving at petitioners' Federal taxable income for 1987 and 1988. This is so, contends the Division, because petitioners entered into an offer in compromise with the IRS for the years 1987 and 1988 prior to the filing of the amended returns for these years which reflected the net operating loss carrybacks from the years 1990 through 1992;
- c. Pursuant to IRC § 6511(d)(2)(A), petitioners had three years from the time the returns were due, including extensions, to claim the carryback. For 1990, petitioners obtained an extension, until October 15, 1991, to file their return. Therefore, pursuant to IRC § 6511(d)(2)(A), petitioners had until October 15, 1994 to claim the carryback. For

the years 1991 and 1992, because of similar extensions, petitioners had until October 15, 1995 and October 15, 1996, respectively, to claim the carrybacks. In the present matter, the amended Federal returns which claimed the carrybacks were filed on or about November 5, 1998,⁷ a period well beyond the time period for claiming the carry backs;

d. The Division also asserts that the evidence reflects that the “diagnostics” which were attached to petitioners’ returns for 1990 through 1992 indicate that petitioners were carrying these losses forward to subsequent tax years;

e. On their Federal returns, petitioners attempted to carry back losses from 1992 to reduce taxable income in 1987 and 1988. However, citing IRC former § 172(b)(1), the Division stated that in 1991 and 1992, the carry back period was three years. Therefore, losses occurring in 1992 could only be carried back to reduce taxable income in 1991, 1990 and 1989. Similarly, petitioners’ Federal returns purport to carry back losses occurring in 1991 to reduce taxable income in 1987; losses in 1991 could only be carried back to reduce taxable income in 1990, 1989 and 1988;

f. Even if it is found that the Division improperly denied petitioners’ claim that the tax deficiencies be eliminated based on the net operating loss deductions, penalties and interest were, nevertheless, properly imposed because the existence of net operating loss carry backs in later years does not excuse a taxpayer from filing correct returns and paying the tax due thereon.

⁷ While the Division asserts that the amended returns for 1987 and 1988 were filed on or about November 5, 1998, the record discloses that the returns were received by the IRS on September 29, 1998 (*see*, Finding of Fact “8”).

CONCLUSIONS OF LAW

A. Tax Law § 659 provides that if the amount of a taxpayer's Federal taxable income is changed or corrected by the United States Internal Revenue Service, the taxpayer shall report such change or correction within 90 days after the final determination of such change or correction and shall concede the accuracy of such determination or state wherein it is erroneous. Pursuant to Tax Law § 681(e)(1), if a taxpayer fails to comply with section 659, a deficiency may be assessed, based upon the Federal change or correction, by mailing to the taxpayer a Notice of Additional Tax Due.

Petitioners' response to the Notices of Additional Tax Due acknowledged that tax deficiencies existed for 1987 and 1988; however, they maintained that they had net operating losses from subsequent years which could be carried back to 1987 and 1988 to eliminate these deficiencies.

B. The New York adjusted gross income ("AGI") of a resident individual means his Federal AGI, with certain modifications (Tax Law § 612[a]). Federal AGI is, therefore, the starting point in calculating New York AGI and is defined in the Internal Revenue Code generally as gross income less certain deductions (IRC § 62[a]). Among the deductions subtracted from gross income to arrive at Federal AGI is the net operating loss deduction (*see*, IRC § 172). There is no statutory provision in the New York State Tax Law which authorizes a New York net operating loss deduction. A net operating loss deduction is, however, accounted for in the calculation of Federal AGI. Clearly, therefore, in order to determine whether, as petitioners contend, there existed net operating losses from subsequent years, i.e., 1990, 1991 and 1992, which could be carried back to offset or eliminate the deficiencies for 1987 and 1988, it is necessary to ascertain whether the IRS accepted petitioners' net operating loss carrybacks

for 1987 and 1988. Pursuant to Tax Law § 689(e), it is petitioners who bear the burden of proving that the IRS did, in fact, accept their net operating loss carrybacks for 1987 and 1988.

C. In the present matter, it is of utmost importance to revisit the timing of the relevant stipulations and filings of returns and amended returns. After issuance, by the IRS, of a Notice of Deficiency to petitioners for the years 1985 through 1988, petitioners and the IRS entered into stipulations of settled issues thereby resolving all substantive issues, with the exception of additions to tax. Pursuant to these stipulations, petitioners acknowledged income tax deficiencies of \$92,439.00 for 1987 and \$12,544.00 for 1988 (deficiencies were also agreed to for other years not relevant to this proceeding). For 1987 and 1988, petitioner agreed to the disallowance of, among other things, claimed Schedule E losses resulting from his involvement in certain partnerships and Subchapter S corporations. The contents of these stipulations and the decision of the Tax Court relative to the additions to tax were set forth in a decision of the Tax Court which was entered on February 14, 1997.

Prior to filing their Federal returns for 1990 and 1991 which were filed late on October 24, 1994 and October 28, 1994, respectively, petitioners' representative, by a letter dated March 8, 1994 to the accountants for two joint ventures which petitioner Stanley Cohen had invested in, advised the accountants that the joint ventures had not properly reported losses for the years 1986 through 1992, thereby denying petitioner the ability to claim losses from the joint ventures. There is no indication that these joint ventures complied with petitioner's request to file a form 8082, Notice of Inconsistent Treatment or Amended Return, or that any other measures were taken to comply with the request. In fact, by virtue of the letter from IRS Agent Szczepanski to petitioner's representative more than three years later (September 29, 1997) which requested additional information (such as petitioner's share of the partnership liabilities, the partnership

agreement and documentation verifying the net operating loss claimed on the 1992 return), it can logically be inferred that the partnership had not complied with petitioner's 1994 request.

Petitioner thereupon supplied additional documentation and, approximately nine months later, on March 24, 1998, Agent Szczepanski notified petitioners that no changes had been made to the tax reported on their 1990, 1991 and 1992 (this return was also filed late on June 21, 1995) returns. On their 1990, 1991 and 1992 Federal income tax returns, petitioners claimed net operating losses of \$97,422.00, \$158,221.00 and \$143,186.00, respectively.

On September 29, 1998, the IRS received amended returns from petitioners for 1987 and 1988. The amended return for 1987 indicated that it had been amended to reflect a carry back of partnership losses from 1990 (\$97,422.00), 1991 (\$158,221.00) and 1992 (\$60,649.00). The amended return for 1988 contained a similar explanation and indicated that the loss to be carried back was \$82,537.00, or the balance of the \$143,186.00 net operating loss from 1992 not previously carried back to 1987. Pursuant to a request from the IRS for additional information concerning the computations of net operating losses for 1990, 1991 and 1992, petitioners, on November 5, 1998 submitted an application for a tentative refund along with their computations of the net operating losses for each of these years.

Shortly after filing these amended Federal returns, the Division, on October 29, 1998, issued the Notices of Additional Tax Due for 1987 and 1988 which are the subject of this proceeding. A little more than six months later, in May 1999, petitioners filed amended New York State returns for 1987 and 1988. On the 1987 amended return, petitioners indicated that the return had been amended to reflect the carryback of partnership losses allowed by the IRS (1990 - \$97,422.00, 1991 - \$158,221.00 and 1992 - \$60,649.00). The 1988 amended return contained a similar explanation and indicated that the loss carried back was from 1992 in the

amount of \$82,537.00, or the balance of the net operating loss from 1992 not carried back to 1987.

When petitioners, on October 28, 1999, requested a letter from the IRS indicating the status of the net operating loss carry backs from 1990 through 1992 to the 1987 and 1988 tax years, the letter stated that “[i]t would be most helpful if you could write us a letter indicating that the NOL’s have been accepted” because “New York State is waiting to approve State filed amended returns and net operating loss carry backs based on the acceptance of the Service’s returns for the years in issue.” In response, the IRS noted that the 1990 through 1992 returns were delinquent returns and were accepted as filed. No mention was made of the net operating loss carry backs.

D. The Division contends that petitioners did not prove that they actually incurred net operating losses during 1990, 1991 and 1992 which could be carried back to offset income tax deficiencies for 1987 and 1988. The evidence presented herein indicates otherwise. The IRS letter of November 10, 1999 indicated that petitioners’ delinquent returns filed for the years 1990 through 1992 had been accepted as filed. That fact, however, does not in any way prove that the IRS accepted petitioners’ subsequent carry back of the net operating losses to 1987 and 1988.

E. Next, the Division asserts that there is no evidence that the IRS utilized net operating losses from 1990, 1991 and 1992 in arriving at petitioners’ Federal taxable income for 1987 and 1988 because petitioner entered into an offer in compromise with the IRS prior to the filing of the amended returns for 1987 and 1988. It must be noted that while the Division’s Response to Taxpayer Inquiry sent to petitioners on December 20, 1999 makes mention of an offer in compromise, this record contains no evidence as to whether such offer in compromise was made

and, if it was made, what the eventual outcome was. Therefore, this contention by the Division is rejected as being unsubstantiated.

F. The Division states that pursuant to IRC § 6511(d)(2)(a), petitioners had three years from the time the returns were due, including extensions, to claim a carryback. Since the amended Federal returns which claimed the carryback were not filed until 1998, a date more than two years beyond the time period permitted for claiming the carry backs, such claims are time barred.

IRC § 6511(d)(2)(a), in effect during the years at issue, provided as follows:

If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss or net capital loss which results in such carryback

Although the Division may well be correct that petitioners' claims for credit against the existing Federal tax deficiencies for 1987 and 1988 were time barred by virtue of their failure to timely claim net operating loss carrybacks from 1990, 1991 and 1992, that cannot be ascertained from the record herein. As previously noted, there is no indication that the IRS ever accepted petitioners' net operating loss carrybacks from 1990, 1991 and 1992 to offset the tax deficiencies for 1987 and 1988. While it is distinctly possible that IRC § 6511(d)(2)(A) may have been the reason for the refusal by the IRS to accept the carrybacks, absent any documentation from the IRS, it is impossible to determine the reason with certainty.

G. While the Division is correct that petitioners' "diagnostics" attached to their Federal returns for 1990 through 1992 indicate that the net operating losses were being carried forward to subsequent years, a careful review of petitioners' returns reveals that while that may have

initially been their intention, the net operating losses were not, in fact, carried over to the subsequent years.

H. The Division contends that during the years at issue, the Internal Revenue Code permitted only a three-year carryback of net operating losses. IRC former § 172(b)(1),⁸ in effect during the years at issue, provided as follows:

(A) GENERAL RULE. – Except as otherwise provided in this paragraph, a net operating loss for any taxable year–

(i) shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and

(ii) shall be a net operating loss carryover to each of the 15 taxable years following the taxable year of the loss.

The Division then asserts that based upon this statute, net operating losses occurring in 1992 could only be carried back to reduce taxable income in 1991, 1990 and 1989, none of which are at issue in this proceeding. Similarly, net operating losses in 1991 could be carried back only as far as 1988 and net operating losses in 1990 could be carried back to 1987.

Again, while it is possible that IRC former § 172(b)(1) was the basis for the failure of the IRS to accept petitioners' claims for credit or refund for 1987 and 1988, that cannot be determined from the record herein. Petitioners must prove that the IRS accepted their claimed net operating loss carry backs and they have failed to do so. It must be noted, however, that petitioners' amended Federal return for 1987 indicated that losses of \$97,422.00 had been carried back from 1990 (which would be permissible pursuant to IRC former § 172[b][1]); however, the amended return for 1987 also indicated that losses from 1991 (\$158,221.00) and from 1992 (\$60,649.00) had also been carried back. The 1988 amended Federal return states

⁸ Recent amendments to IRC § 172(b) have reduced the carry back period to the two years preceding the taxable year of the net operating loss.

that the loss carried back was from 1992 and was in the amount of \$82,537.00.⁹ On its face, these carrybacks appear to be contrary to the provisions of IRC former § 172(b). But it is unclear if this is the reason for the failure of the IRS to accept petitioners' carry backs of net operating losses to 1987 and 1988.

In summary, while several of the Division's contentions as to possible reasons for the failure of the IRS to approve petitioners' net operating loss carry backs to 1987 and 1988 appear to be meritorious, it cannot be ascertained, with any degree of certainty, why such carry backs were not, in fact, accepted. Since petitioners bear the burden to prove that the IRS did accept such carry backs and have failed to do so, it is unnecessary to speculate as to the reasons therefor. It is sufficient, for purposes of this proceeding, to find that petitioners failed to sustain their burden to show that the IRS accepted their claimed net operating loss carrybacks from 1990, 1991 and 1992 to offset income tax deficiencies for the years at issue, 1987 and 1988. Accordingly, the deficiencies for such years imposed by the Division are sustained in their entirety.

I. Finally, on each Notice of Additional Tax Due, a negligence penalty of 5% was imposed pursuant to Tax Law § 685(b)(1) and a penalty pursuant to Tax Law § 685(b)(2), equal to 50% of any interest due attributable to negligence or intentional disregard of the Tax Law was also imposed by the Division. For 1988, a penalty pursuant to Tax Law § 685(a)(1), a late filing penalty, was also imposed.

Petitioners, in their reply brief, contend that "the availability to carry back the net operating losses did not arise until the determination of the Tax Court's Decision and until the

⁹ Petitioners' New York State amended returns for 1987 and 1988 reflect the identical amounts from the same years.

adjusted basis was established by the submission of the original filed returns for 1990, 1991 and 1992.” This contention must be rejected. First, petitioners and the IRS entered into stipulations which settled the issues relating to the tax deficiencies for 1987 and 1988 which resulted in Federal income tax deficiencies. Subsequently, a decision of the Tax Court, entered February 14, 1997, held petitioners liable for certain additions to tax. By virtue of Tax Law § 659, petitioners had 90 days to notify the Division of these changes and this record contains no such notification to the Division by petitioners at any time. It was not until the Division issued the Notices of Additional Tax Due approximately one and one-half years later, on October 29, 1998, that petitioners initiated any communication with the Division regarding their 1987 and 1988 tax liabilities when they responded, on November 5, 1998, to the notices by informing the Division that they had filed amended Federal returns for 1987 and 1988 reflecting carry back of losses to eliminate the tax liabilities for those years (it must be noted that they did not file amended State returns until May 1999).

As the Division has correctly noted in its brief, the existence of net operating loss carrybacks in subsequent years does not excuse a taxpayer from timely filing correct returns and paying the tax due thereon because, by his failure to pay the taxes owed, the taxpayer had the use of funds which rightfully should have been in the possession of the United States. A subsequent carryback which results in abatement of the deficiency does not abate the interest previously assessed on that deficiency (*Manning v. Seeley Tube & Box Co.*, 338 US 561, 94 L Ed 346). Even though a carryback of a net operating loss eliminates the tax for a given year, penalties incurred for failure to file a return or to pay the tax for that year within the prescribed time are not affected by the carryback (*Simon v. Commissioner*, 248 F2d 869; *see also*, Rev Rul

72-484, 1972-2 CB 638). Accordingly, penalties and interest imposed upon the deficiencies are sustained.

J. The petition of Stanley and Jean Cohen is denied and the Notices of Additional Tax Due issued on October 29, 1998 are hereby sustained.

DATED: Troy, New York
February 20, 2003

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE